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Introduction

I am pleased to have the opportunity this morning to participate in the first public hearing of the U.S.-China Security Review Commission.

I joined with Senator Byrd and Senator Dorgan in sponsoring the legislation which established the Trade Deficit Review Commission, which was the predecessor to this Commission. The report produced by that Commission did an excellent job of laying out the challenges posed by the trade deficit and the competing views of how that challenge could be met. On balance I thought the report performed a very useful public service.

I am very hopeful that the work of this Commission will be equally valuable. According to the legislation which established the Commission, its purpose is "to monitor, investigate, and report to Congress on the national security implications of the bilateral trade and economic relationship between the United States and the People's republic of China.." The legislation requires the Commission to submit an annual report to Congress on its findings.

I believe that the U.S.-China trade relationship should be considered in the context of our overall relationship with China, including national security, foreign policy, human rights, labor rights, and the environment. I support Permanent Normal Relations with China which would link all of our diverse interests with China into an integrated policy. I did not support granting Permanent Normal Trade Relations (PNTR) to China, which is one of the issues under consideration in your hearing this morning, because in my view it would in effect separate trade from our other important concerns with China.

For that reason I believe the Commission has a very important role to play in shining a light on the impact of the U.S.-China trade relationship on our national security relationship with China. I am very supportive of the work you have to do, and I very much look forward to reviewing the reports you produce.

The subject of your hearing today is U.S.-China Trade and Investment Policies and Their Impact on the U.S. Economy. Since this is a subject of great concern to me, I would like to make a few comments about it.

The U.S. Trade Relationship with China

The United States' bilateral trade relationship with China is arguably our most one-sided bilateral trade relationship in the world.

It is well known that the U.S. has been running a steadily increasing trade deficit with China for nearly two decades. In 1983, the U.S. had a bilateral trade deficit with China of $72 million. It fell to a deficit of $9 million in 1985. Since then it has set a new record every year, rising from $1.6 billion in 1986 to $10.4 billion in 1990 to $29.4 billion in 1994 to $56.8 billion in 1998 to $68.7 billion in 1999. The Commerce Department reported that in 2000 the U.S. trade deficit with China reached a record $83.8 billion. Last year the U.S. trade deficit with China surpassed the U.S. trade deficit with Japan ($81.3 billion).

Although the U.S. trade deficit with China is only slightly larger than our deficit with Japan, it is important to recognize that relative to the size of our overall volume of trade with China, the U.S. trade relationship with China is far more one-sided than our trade relationship with any other country in the world. For example, the U.S. bilateral trade deficit with Japan in 2000 was $81.3 billion. That trade deficit was based on a total volume of trade with Japan of $211.9 billion (made up of $65.3 billion in exports and $146.6 billion in imports). In contrast, the $83.8 billion U.S. trade deficit with China was based on a total volume of trade of $116.4 billion (made up of $16.3 billion in exports and $100.1 billion of imports).

Although Japan's total volume of trade with the U.S. is only about twice as large as China's, Japan bought four times more exports from the United States than did China. This is despite the well known trade difficulties the U.S. has experienced with Japan. This pattern is repeated to an even greater extreme with the other largest U.S. trading partners - Canada, the European Union, and Mexico. In 1999, exports made up 45.2% of total U.S. trade with Canada, 43.7% of our trade with the European Union, and 44.2% of our trade with Mexico. Even with Japan, exports made up 30% of our total volume of trade. Exports made up 13.8 % of our trade with China.

Even compared to the other largest U.S. trading partners in Asia, the U.S. trade relationship with China is extraordinarily one-sided. In 2000, countries such as Taiwan. South Korea, and Singapore purchased more exports from the U.S. than did China, even though the U.S. volume of trade with Taiwan and South Korea is little more than half the volume of U.S. trade with China, and the U.S. volume of trade with Singapore is a little more than a third of its volume of trade with China .

It is also worth examining China's trade relationship with Japan and the European Union as compared with the United States. In 2000, China's total volume of trade with the U.S. it was $116.4 billion, with the EU it was $94 billion, and with Japan it was $85.7 billion. Thus the U.S. is China's largest trading partner in the world.

While China ran trade surpluses with all three of its major trading partners, its surpluses with the U.S. were by far the largest not only in absolute terms but also relative to the overall volume of trade. China ran a surplus with the U.S. of $83.8 billion, with Japan of $24.9 billion, and with the EU of $44.9 billion. Thus China's surplus with the U.S. was more than three times the surplus with Japan and nearly than twice the surplus with the EU, far out of proportion to China's overall volume of trade with each of its three major trading partners .

It could be argued that China runs a larger trade surplus with the U.S. because the U.S. market is more open than the markets of Japan and the EU, and thus takes in a larger volume of exports from China. While this may be true, it is also true that China purchases a substantially larger volume of exports from Japan and the EU, even though overall it has a larger volume of trade with the U.S. In 2000 China purchased $30.4 billion of exports from Japan, $24.5 billion of exports from the EU, and $16.3 billion in exports from the U.S. While the U.S. was by far the largest market for exports from China, China purchased more exports from Japan, the EU, & Taiwan than from the U.S.

It has been argued that most exports from China to the United States are not made in the United States and therefore do not compete with U.S. products. As a result, it is argued, some of the increase in Chinese exports to the United States has come at the expense of exporters in third countries, such as Mexico, South Korea, and Taiwan, not at the expense of U.S. manufacturers. It is worth noting that although these other countries also run trade surpluses with the U.S., the U.S. balance of trade with these countries is not nearly as one-sided as with China.

However, this analysis has limited validity. The Congressional Research Service reports that in 1999 the top six U.S. imports from China by dollar value were miscellaneous manufactured articles, footwear, office machines and automatic data processing machines, telecommunications and sound equipment, apparel and accessories, and electrical machinery. According to CRS :

> "While U.S. imports in all these categories have increased, the most dramatic percentage changes have not been in sectors such as footwear and apparel - traditional labor intensive industries in which China is quite competitive - but in high technology sectors, such as office and data processing machines (up 1404% from 1992-99), electrical machinery and appliances (up 430%), and telecommunications and sound equipment (up 316%)."

According to CRS, this trend held up in 2000. The character of imports from China is shifting to increasingly sophisticated categories of products which compete directly with goods made in the U.S.

The U.S. Investment Relationship with China and Its Impact on Trade

Some observers have argued that the prospects for opening the Chinese market may actually be better than those of opening the Japanese or Korean markets at a comparable stage of development. These observers point out that China is much more open to foreign investment than Japan or Korea were. In fact, China has actively sought foreign direct investment as sources of western capital and technology. Foreign direct investment has been a key element of China's development strategy.

China's receptiveness to foreign investment does not necessarily mean, however, openness to imports. In fact, trade barriers in sectors such as automobiles have been part of China's strategy to encourage foreign investment. Since the Chinese market could not be accessed easily through exports, western automakers that wanted a portion of the Chinese market were effectively forced to invest. Once inside the market, many western companies took a different view of Chinese trade barriers because they now also protected them from competition from outside China.

The unstated assumption is that openness to foreign investment will eventually lead to openness to foreign trade. It is not clear, however, that reforms undertaken to encourage foreign investment will inevitably lead to lower trade barriers and more imports. In fact, China's increasing demands for domestic production and transfer of technology suggest that the opposite may be true.

An article in the Wall Street Journal on May 25, 2000 the day after the House voted on PNTR, focused on the investment aspect of the China WTO agreement. The article stated:

> "Even before the first vote was cast yesterday in Congress's decision to permanently normalize U.S. trade with China, Corporate America was making plans to revolutionize the way it does business on the mainland. And while the debate in Washington focused mainly on the probable lift for U.S. exports to China, many U.S. multinationals have something different in mind. 'This deal is about investment, not exports,' says Joseph Quinlan, an economist with Morgan Stanley Dean Witter & Co. 'U.S. foreign investment is about to overtake U.S. exports as the primary means by which U.S. companies deliver goods to China.' "

A comparison of U.S. trade with China and U.S. investment in China over the past decade is instructive. From 1991 to 1999, U.S. exports to China increased on an annual basis from $6.2 billion to $13.1 billion, slightly more than doubling. Imports from China during that same period rose from $20.3 billion to $81.7 billion, more than a four-fold increase. During that same period U.S. foreign direct investment in China rose from $323 million in 1991 to $4.3 billion in 1999, a thirteen-fold increase. Whereas the U.S. ranked behind Japan, the European Union, and Taiwan as a source of exports to China, it ranked ahead of all of them as a source of foreign direct investment in China.

Rather than expanding exports and reducing the U.S. trade deficit with China, China's purpose in encouraging U.S. investment in China may be the opposite.

Conclusion

Let me conclude by reiterating my strong support for the work of the Commission. It is difficult to escape the conclusion that the large bilateral trade surpluses that China runs with the United States are used at least in part to support China's military establishment. China's policies for attracting foreign investment and technology also have significant national security implications. This is an important area that perhaps has not received sufficient attention and study. The Commission therefore has an opportunity to make a major contribution in increasing understanding of this important aspect of the U.S.-China relationship.